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**Subject:** Truth in Lending

October 11, 2007

From:  
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To:  
Jennifer L. Johnson, Secretary  
Board of Governors  
Federal Reserve System  
20th and Constitution Ave., N.W.  
Washington, DC 20551

By email to: [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov)

Re: Comments to Docket No. R-1286  
Regulation of Credit Cards

Dear Ms. Johnson:

I write to comment on the Board's proposed revisions to credit card and other open end credit disclosures under the Truth in Lending Act (TILA).

As the author of numerous publications on consumer credit issues, including "What Every Credit Card User Needs to Know" (Owl Books/Henry Holt), and as someone who, for many years, has taught classes for adults with credit issues, I am happy that the Board has finally gotten around to, hopefully, doing something about the scandal of credit card disclosure and regulation.

Information about the costs of credit cards must be fully conveyed to consumers and there must be vastly increased oversight on the increasingly sleazy credit card industry. If the Board does not step up to the plate, then Congress will have to come up to bat. And, quickly.

The Board's proposals provide a few somewhat positive steps to enhance credit card disclosures, such as standardizing the format of disclosures throughout the life of an account, requiring forty-five days advance notice for changes in terms, and requiring forty-five days notice for imposition of a penalty rate. While a slight improvement, even so, the forty-five day period is far, far too short.

On the other hand, the Board proposes several measures that will drastically reduce or even eliminate critical pricing disclosures for credit cards.

These proposals will leave consumers with less information and give creditors huge loopholes for new, abusive fees, etc.

Most problematically, the Board's proposal does little to address substantive credit card abuses. Even where the Board has clear authority to enact substantive regulation, it has chosen

disclosure over substantive, real protection. The Board should use its rulemaking authority to enact substantive protections for consumers, or, within this year of 2007, ask Congress to enact protections against the terrible abuses of the credit card industry.

## **I. Proposals To Improve the Format and Timing of Disclosures Will Benefit Consumers & The Economy in General**

I support the following proposals by the Board, which I believe will somewhat improve credit card disclosures--and, of course, better disclosure and honesty in the credit market will benefit our market economy by enhancing competition.

- *Requiring the use of a table for disclosure of critical terms at important stages of a credit card account.* I support the proposal to require the use of a mandatory table format to disclose critical terms at more stages of the credit card “life cycle.”

Currently, the only disclosures that require such a table, often referred to as a “Schumer box,” are those given at the application or solicitation stage. The Board proposes to require a similar table when the account is actually opened, and when the creditor provides a change in terms notice. This proposal will improve the readability of credit card disclosures and provide more information to consumers.

- *Extending the change in terms notice period from fifteen to forty-five days—Should be one year.* Currently, Regulation Z requires creditors to provide a change in terms notice 15 days before the change takes effect. The Board is proposing to lengthen this notice period to 45 days. This is a slight real improvement. While I support it, I urge the Board to consider much better protection - that a term to be in place, at a minimum for one year. There is no need for card issuers to change their terms so quickly. Let them adhere to the terms of the contracts they make with card holders.

- *Requiring forty-five days notice before: (1) imposing a penalty rate or (2) if a reduction in credit limit results in imposition of an over limit fee or penalty rate.* This proposal will help consumers, and I support it. However, the proposed notice is far too short and should be at least ninety days. In addition to the increased notice, I support the Board’s proposal to improve the disclosure of penalty rates in the applications/solicitation and account opening disclosures.

- *Prohibiting use of term “fixed” unless the interest rate is really fixed.* Currently, creditors use the term “fixed” in describing interest rates, but reserve the right to change these rates at will and to impose penalty rates. The proposal would prohibit the use of the term “fixed” unless the interest rate really will not change for a certain period of time, which must be disclosed, or is fixed forever. I support this proposal, because it addresses a significant abuse by creditors who advertise low “fixed” rates, but then change the rates later.

- *Addressing some sub prime abuses.* The Board has proposed a few improvements targeted at sub prime credit cards, most notably requiring a disclosure when the fees or security deposit charged to a credit card exceed twenty-five percent of the card’s credit limit. While not curbing most of the very egregious abuses of sub prime cards, the proposal may help some consumers become aware of the traps of these cards.

However, I believe that the threshold for these disclosures should be lower, requiring disclosure when the fees or deposit on the card exceeds five percent of a card’s credit limit.

## **II. Proposals That I Am Concerned About**

The Board has made three proposals that will radically reduce the content and meaningfulness of

credit card disclosures. I am most concerned about these proposals.

*a. Permitting Creditors To Disclose A Range Of APRs In The Application Disclosures, So That The Creditor Can Later Assign An APR After Reviewing The Consumer's Credit Score.*

The Board has proposed permitting creditors to disclose a range of Annual Percentage Rates (APRs) in credit card application disclosures, allowing card issuers to make a post-application review of the consumer's credit score. Creditors would be permitted to delay disclosure of the actual APR that the creditor is offering until the consumer receives the account opening disclosures (often along with the credit card itself). This is remarkably anti-consumer and can only lead to deception and sleazy marketing tactics, such as advertising a range of rates, but, always, or almost always actually issuing the account at the highest rates.

The Board's own sample form for credit card application disclosures gives the following example as a model for disclosure:

**8.99% to 19.99%** when you open your account, based on your creditworthiness.  
After that, your APR will vary with the market based on the Prime Rate.

The Board's so-called "model" disclosure provides no useful or helpful information. It does not tell the consumer what he or she is applying for. There is an eleven percent spread in these rates, which is a truly gigantic difference. On a \$1,000 balance, that is an annual difference of over \$100 in interest. Allowing such a meaningless disclosure not only permits bait and switch tactics, it encourages them. Consumers need **FULL, BINDING DISCLOSURE AT THE TIME OF INITIAL DISCLOSURE**.

This problem is especially acute with respect to balance transfers. The Board proposes to permit creditors to disclose a range of APRs, then assign the real APR *after* the consumer has initiated the balance transfer. With balance transfers, consumers often move balances of hundreds or thousands of dollars, thus committing themselves to significant liability under the terms of the account. Consumers should not be forced to make the decision to transfer hundreds or thousands of dollars in debt blindly, just to make it more convenient for creditors to engage in what they claim is risk-based pricing (a most dubious claim, given the well-known inadequacies of the credit reporting system).

*b. Limiting Fees Required to Be Disclosed to an Exclusive List*

The Board has proposed to drastically limit the number of fees that creditors are required to disclose at account opening and for change in terms notices. The only fees that creditors will be required to disclose in these notices are:

- \*Annual or other periodic fee
- \*Transaction fees - cash advance, balance transfer, ATM or currency conversion fee
- \*Penalty fees - late payment, over limit, or returned payment fee
- \*Minimum finance charge

For all other fees besides these four categories, the creditor need only disclose the fee at any time

prior to when the fee is imposed. Furthermore, these other fees can be disclosed orally, without the requirement of written documentation. Finally, only the fees in the four specific categories will require change in terms notices.

The Board's proposal will encourage creditors to develop new fees outside of these four categories that do not need to be disclosed ahead of time and in writing. Creditors will shift their profit structure to rely on revenue from these new fees, moving away from the ones that the proposed rule requires to be disclosed in the table. Like the children's arcade game of "whack a mole," the efforts by consumer advocates and Congress to address current abusive fees will be for naught as new fees pop up to replace the current ones.

*c. Modifying or Even Eliminating the Effective APR*

The Board is proposing two alternatives for the effective APR. The first alternative would be to modify it. The second would be to eliminate it.

I am strongly opposed to eliminating the effective APR. That the Board has even contemplated eliminating the effective APR is **outrageous and unacceptable**. The effective APR and its calculation are specifically mandated by Section 1606 of TILA for open-end credit. The Board's proposal flies in the face of the very reason Congress enacted TILA, because it would eliminate the **only** APR in open end credit that reflects the price imposed by fees and non-periodic interest finance charges. **The Board's proposal abandons a core principle of Truth in Lending.**

The Board's stated rationale for this alternative is that consumers are confused by the effective APR and do not understand it. This is the same "confusion" argument often used by high cost lenders, such as payday lenders. In fact, the Board's proposal provides ample incentives for payday lenders to convert their predatory loan products into open ended credit. These payday lenders could charge only fixed or transaction fees and thus disclose the APR on these products as 0%. Such products are already on the market, such as the product that payday lender Advance America offered in Pennsylvania, which carried a "participation fee" of \$149.95 *per month* for a credit limit of \$500 and a 5.98% periodic APR. This translates into an effective APR of over **350%**. Yet if the Board eliminates the effective APR, Advance America would never need to disclose that 350% figure and would only disclose a 5.98% periodic APR.

Indeed, the Board admits in its analysis that an effective APR is the best way to provide information about an open end credit product that did not impose periodic interest charges but only transaction or flat fees. The Board notes these products are not common; however, they will be everywhere if the effective APR is eliminated.

As even one industry trade group conceded, the effective APR is "a hedge against creditors shifting their pricing from periodic rates to transaction-triggered fees and charges."

Eliminating the effective APR also completely undermines the concept of the finance charge under TILA, because there is no unitary number that includes all of the different types of finance charges (*i.e.* , interest, fees that are a percentage of a transaction, and flat fees) in its calculation. Thus, the FRB's changes to treat more fees as finance charges, which I support, have no real meaningful impact without the effective APR. If consumers are confused by the effective APR, the solution is to improve the disclosure, not eliminate it. The Board has taken one step, discussed below, by re-labeling it as a "fee inclusive APR" and providing an explanation. The Board needs to move further in that direction, not get rid of the most informative measure of the

cost of credit in credit cards.

I support strengthening the effective APR disclosures.

The Board's second alternative is to modify the effective APR by -

- labeling it the "Fee Inclusive" APR and requiring an explanation of what it means;
- limiting the fees included in the calculation of the effective APR to 5 categories – periodic interest, transaction charges (cash advance, balance transfer), mandatory credit insurance/debt cancellation, minimum finance charges, and account activity/account balance fees;
- requiring disclosure of a separate effective APR for each fee.

I support the first modification - to rename the effective APR as the "Fee Inclusive APR" and to explain it better. The new name and explanation is a significant improvement.

I am concerned about the second and third modifications. Limiting the effective APR to only the enumerated categories of fees will, for the same reasons as stated in the section above, permits creditors to play "whack a mole" with their fees. Creditors will start charging fees that do not fall in these categories so that they will not have to disclose an effective APR for them.

The third modification proposed by the Board to the effective APR is also problematic. By requiring a separate effective APR for each fee, this only calculates the APR using one fee at a time. By not adding the fees together in the effective APR calculation, the proposal understates the true cost of credit.

### **III. The Proposed Disclosure is Not Enough**

Despite its considerable improvement to credit card disclosures, the proposed rule is woefully inadequate to combat the most serious of credit card abuses. Disclosures alone will never adequately protect consumers.

The proposed rule fails to prohibit the worst of credit card practices, such as:

- Universal default or its variant "adverse action re-pricing"
- Retroactive application of interest rate hikes
- Over limit abuses (the fact that the creditors permit consumers to go over the limit, then charge outrageous fees for tripping up the consumer)
- The sheer excessiveness of the amount of penalty fees, or the sky high APRs for penalty rates
- Hair trigger tactics to impose penalty fees and rates, such as heavy-handed late payment rules.
- Payment allocation abuse
- Payment posting abuse
- Unilateral changes in terms

The Board has improved disclosures regarding some of these practices, but the disclosures simply better inform consumers about how they are going to be abused.

Disclosures alone are not sufficient to protect consumers from over-reaching creditors because:

- Consumers lack equal bargaining power – no consumer has the market power to call up a credit card company and negotiate either the basic terms or those in the adhesion contract.

- The credit card market does not provide real choices. With the dramatically increasing consolidation of credit card providers, the industry guarantees less meaningful competition. And if the consumer does not have a good credit score (and a less than excellent credit score often triggers abusive practices such as universal default), she or he has little or no options for an affordable credit card.

Without some basic substantive regulation, there will continue to be competition between industry players only as to which can garner the most profit from the most consumers – regardless of the fairness, or the effects on consumers.

The Board has the authority to ban banking practices that are unfair or deceptive under the Federal Trade Commission Act. 15 U.S.C. § 57a(f). It also has authority under TILA to address some substantive abuses, such as payment posting and allocation abuses under Section 1666c. **Still, it has taken no action to address these abuses.**

The Board's failure to act is particularly glaring in light of the preemption of substantive state law protections. Thirty years ago, states protected consumers from abusive banking practices. Today, preemption has eliminated those protections without replacing them with any parallel federal protections.

**To the extent that the Board cannot ban certain practices using its FTC Act authority or TILA, I also urge the Board to weigh in with Congress to ask for true reform of the credit card industry.** The message should be: pass federal legislation that will protect American consumers from the increasingly unfair, abusive, and virtually unavoidable practices of the credit card industry. Real, substantive limits on the terms of credit, and the cost of the credit, including the interest rate and all fees and charges, must be re-imposed. I recommend substantive regulation along the following lines–

- A total cap on all periodic interest rates, for example, prime plus 10%.
- A limitation on fees and charges to an amount the creditor can show is reasonably related to cost (this has worked before in credit card regulation in the States).
- No unilateral adverse changes in terms for no reason or no good reason.
- A ban on retroactive interest rate increases.
- No universal default or penalties for any behavior not directly linked to the specific card account at issue.
- No over-limit fees allowed if the creditor permits the credit limit to be exceeded or has not taken reasonable steps to prevent over-limit charges.
- A ban on repeated or “rollover” late and over limit fees.
- No improvident extensions of credit – real underwriting of the consumer's ability to pay should be required.
- No mandatory, binding, arbitration, either for consumers' claims, or for collection actions against consumers.
- MUCH tougher TILA penalties that provide real incentives to obey the rules. As long as the card issuers find it more profitable to abuse consumers than to provide a good product at a fair price (as many do today), consumer abuses will continue.
- A private right of action to enforce Section 5 of the Federal Trade Commission Act, which prohibits unfair or deceptive practices by businesses, including banks.
- Restrictions on lending to youth, including student credit cards and on-campus solicitation.

#### **IV. Conclusion**

It is good that the Board and staff are looking into the mighty big problems with credit card disclosures.

But, there is much more work to be done. I urge the Board to undertake a new rule making to declare credit card abuses to be unfair practices. For those practices that may require Congressional action, I urge the Board to use its substantial influence to recommend such legislation to Congress.

Thank you for the Board's consideration of my views.

Howard Strong  
Attorney at Law